



BUSINESS LAW SECTION

CORPORATIONS COMMITTEE

THE STATE BAR OF CALIFORNIA

180 Howard Street

San Francisco, CA 94105-1639

<http://www.calbar.org/buslaw/corporations/>

September 10, 2008

The Honorable Arnold Schwarzenegger
Governor, State of California
State Capitol
Sacramento, CA 95814

AB 2944 (Leno) – Veto Request Corporations Committee of the Business Law Section of the State Bar

Dear Governor Schwarzenegger:

The Corporations Committee (the “Corporations Committee”) of the Business Law Section (the “Section”) of the State Bar of California, composed of practitioners with extensive experience and expertise in the field of corporate law, urges you to veto AB 2944 by Assemblyman Mark Leno (“AB 2944”).

AB 2944 seeks to change California corporate law to allow directors of California corporations to place broad societal interests ahead of the interests of corporate shareholders when making decisions to approve corporate action. Specifically, AB 2944 would:

- modify Section 309 of the California Corporations Code (the “Code”) to expressly provide that directors of a California corporation, in considering the best interests of the corporation and its shareholders, may consider, without limitation, the factors listed in AB 2944 and any other appropriate factors consistent with the business judgment rule, to the extent that they deem appropriate. AB 2944 insulates directors from individual liability for basing decisions on such factors (without regard to interests of the corporation’s shareholders), and provides that directors shall be presumed to be acting in the best interests of the corporation absent a showing of a breach of fiduciary duty, lack of good faith or self-dealing; and
- if a California corporation’s articles of incorporation are amended accordingly, mandate that such presumption also apply (and no higher burden of proof be used) to evaluate directors’ conduct relating to or affecting a sale (or other acquisition of control) of a California corporation, if such act is approved by a majority of disinterested directors unless the disinterested directors did not assent to the act in good faith after reasonable investigation.

Proponents of the bill state that AB 2944 will make California more attractive to business and investors. However, the Corporations Committee respectfully questions the efficacy of setting forth numerous factors that cloud rather than clarify the question of what interests directors should consider in discharging their fiduciary duties to the corporation and its shareholders. More importantly, AB 2944 provides a list of several factors for directors to consider and permits directors to consider any other appropriate factors consistent with the business judgment rule, with no guidance as to what weight to give each factor, nor any procedure for deciding among competing factors. The bill also specifically permits directors to conclude that the long-established standard of fiduciary duty embodied in the current law – preserving long term and short term economic interests of the shareholders – can be deemed irrelevant either in the abstract or in comparison with various other factors. The Corporations Committee believes that enacting this bill will create a significant disincentive for investors to invest in California corporations. In our view, AB 2944 will have the opposite effect of encouraging investors to incorporate in other states where shareholder interests are held paramount. We submit that AB 2944 is significantly out of step with the overall trend and investor demands for greater director accountability to shareholders, not less.

Moreover, the Corporations Committee believes AB 2944 is unnecessary because current law is not an impediment to responsible corporate behavior and there are less intrusive means of protecting the interest of non-shareholder constituents and promoting socially beneficial actions by corporations.

The Corporations Committee has no objection to formalizing an intention to create benefit for interests and interest groups beyond the traditional interests of shareholders (popularly referred to as “B corporations”). However, the Corporations Committee believes it is not proper to attempt to implement such a regime and have it apply to all domestic California corporations. If the legislature believes that the establishment of B corporations is in the best interests of the corporate community, such provisions should be set forth in a separate subdivision of the Corporations Code recognizing the existence of B corporations separate and apart from general corporations. Indeed, the Corporations Committee offered to provide assistance in an effort to authorize formation of B corporations separate from other business entities recognized under the Corporations Code in lieu of the approach reflected in AB 2944, and continues to be available to provide such assistance in the event such efforts are pursued.

The Corporations Committee is further prepared to accept the flexibility permitting existing general corporations to convert to the B corporation form (if it is recognized under such separate provision of the Corporations Code) as long as such separate provision within the Corporations Code includes appropriate procedural protections, including (at a minimum) an “opt in” procedure, dissenter’s rights for shareholders who do not wish to be converted into investors in a B corporation and creditor notice of such election by a corporation. In contrast, the *only* requirement in AB 2944 for shareholder approval regarding decisions of the directors under it is limited to the acquisition context. The bill subjects the shareholders to all other aspects of it *without their consent*. The Corporations Committee strongly believes that AB 2944 dilutes the rights of shareholders and accountability of directors and that the regime set forth in AB 2944

should not be imposed upon any shareholder without consent. Moreover, AB 2944 provides no protection at all to creditors even though there are circumstances when the corporation enters into the zone of insolvency in which creditors are owed the same fiduciary duties by directors as shareholders.

In summary, we can see the potential value for shareholders wishing to form or become investors in a corporate entity with standards of fiduciary duties that depart from the norm. But we cannot see any value in exposing shareholders to reduced accountability of directors so that special interest groups can pursue their agenda to the detriment of the remaining shareholders or creditors who have provided capital to the company in good faith reliance on existing fiduciary duties of directors. We urge you to veto AB 2944 and thereby preserve the historic protection of shareholders that has been long been a hallmark of California law.

If you or your staff has any questions concerning AB 2944 or our position, please feel to contact the undersigned on behalf of the Corporations Committee at (650) 327-0100 or Jennifer Wada, Legislative Representative for the State Bar Sections, at (916) 448-4000.

This statement is that only of the Corporations Committee. The positions expressed herein have not been adopted by the Business Law Section or its overall membership or by the State Bar's Board of Governors or its overall membership, and are not to be construed as representing the position of the State Bar of California. There are currently more than 8,800 members of the Section. Membership in the Section is voluntary and funding for its activities, including all legislative activities, is obtained entirely from voluntary sources.

Sincerely,

W. Derrick Britt
Vice Chair for Legislation

cc: Hon. Mark Leno, Member of the Assembly
Curt Augustine, Legislative Deputy to the Governor
Carol K. Lucas, Chair of the Executive Committee of
the State Bar of California Business Law Section
Jennifer M. Wada, Legislative Representative,
State Bar Sections
Anthony C. Williams, Legislative Representative,
State Bar of California